G-001/M-93-1219 ORDER APPROVING PETITION AND REQUIRING FILING

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of a Request by Interstate Power Company for Approval to Increase Its Pipeline Demand Entitlements and to Recover the Associated Costs in Its Monthly Purchased Gas Adjustment Pursuant to Federal Energy Regulatory Commission Order 636	ISSUE DATE: September 20, 1994 DOCKET NO. G-001/M-93-1219 ORDER APPROVING PETITION AND REQUIRING FILING

PROCEDURAL HISTORY

On November 29, 1993, Interstate Power Company (Interstate or the Company) filed a request to increase its total firm entitlements on the Northern Natural Gas Company (Northern) pipeline. Interstate also requested permission to convert its Northern demand entitlements to conform to Northern's restructured services and tariffs. In addition, Interstate requested authority to recover charges for Northern's new services and transition costs in the Company's monthly purchased gas adjustment (PGA).

On June 24, 1994, the Department of Public Service (the Department) filed its report and recommendations. The Department supported the Company's request to increase and restructure its entitlements, but recommended modifications to the Company's cost recovery methods. The Department also recommended further filing requirements, a customer refund, and a modification to the Company's accounting methods.

On July 1, 1994, Interstate filed responsive comments. The Department responded on July 18, 1994.

The matter came before the Commission on September 8, 1994.

FINDINGS AND CONCLUSIONS

I. Factual Background

A. Effects of FERC Order 636 on the Gas Industry

Federal Energy Regulatory Commission (FERC) Order 636 is part of an overall federal policy decision to let market forces operate more fully in the provision of gas services. Among other things, FERC Order 636 completely unbundles gas transportation and sales services; mandates equal and open access to pipeline transportation services; eliminates the pipelines' obligation to provide bundled gas ("the merchant function") and allows pipelines to pass through transition costs, subject to a prudence review by the FERC. FERC Order 636 required all interstate pipelines to restructure their services and tariffs by November 1, 1993, to reflect these changes.

Order 636 profoundly affected local distribution companies (LDCs) as well as the interstate pipelines. The required restructuring brought LDCs new responsibilities, opportunities, and costs.

Under Order 636, LDCs can no longer rely on pipelines to supply bundled gas sales service, nor can they rely on FERC to set rates for pipeline supply service. LDCs have new responsibilities to secure reliable, economic gas supplies and transportation services, to acquire storage facilities to cover short-term shortages, and to monitor pipeline systems to determine when to release unneeded capacity.

Order 636 has brought LDCs new opportunities as well as responsibilities. The capacity release program allows LDCs to manage and control costs. LDCs can take advantage of the new, more competitive market by developing and managing their own supply portfolios.

Order 636 has also brought additional costs to LDCs. The LDCs' stricter "balancing" responsibilities, which require the LDCs to nominate (tell the pipeline) the daily amount of expected gas, can bring penalty costs if the estimates are sufficiently inaccurate.

B. Transition Costs

Transition costs are another additional cost to LDCs resulting from Order 636. Transition costs are the pipelines' costs of conversion from bundled sales and transport functions to strictly transport service. Transition costs include such costs as stranded investment and contract buyouts. The FERC has said that pipelines may pass to their customers, the LDCs, the pipelines' prudently incurred costs of transition to their new status as providers of unbundled pipeline service.

Under Minn. Stat. § 216B.16, subd. 7, the Commission may allow a gas utility to pass the costs of "federally regulated wholesale rates for energy delivered through interstate facilities" to its customers through its PGA.

C. Identification and Allocation of the Transition Costs

If the Commission allows a gas utility to pass the transition costs to customers through the PGA, the next issues are the identification and the allocation of the costs. The costs may be billed as commodity (the amount paid by the utility for the gas supplies) or as demand (the amount paid by the utility to reserve capacity). Commodity charges are typically billed to all sales customers (both firm sales and interruptible sales). Demand charges are typically billed to all firm customers (firm sales and firm transportation).

II. The Petition

In its petition Interstate requested authority to convert its demand entitlements to conform with Northern's services and tariffs as they were restructured under FERC Order 636. Interstate requested an increase in the level of its firm entitlements and an increased level of FDD (Northern's firm gas storage service). Interstate also asked for authority to recover in its PGA the Northern charges for FERC Order 636 new services and transition costs.

Interstate proposed to recover as commodity charges the costs of two of Northern's new services--System Management Service (SMS) and System Balancing Agreement (SBA). Northern's SMS is a no-notice transportation service for which Northern bills reservation and capacity charges. SBA surcharges are imposed by Northern upon all firm shippers, including Interstate. All firm shippers are required by Northern to enter into System Balancing Agreements, under which the shippers must allow Northern to use the shippers' facilities and gas supplies to maintain the integrity and reliability of Northern's system.

Interstate also proposed to recover the costs of the increased FDD service as commodity costs. Interstate planned to recover all commodity costs from firm and interruptible sales customers. Interstate reasoned that under FERC Order 636 it would be arranging for transport and balancing systems supply for all sales customers. Since all sales customers will be contributing to these costs and using the Company's services, all sales customers (both firm and interruptible) should be paying for them.

In its petition Interstate also proposed to recover Northern's "Canadian" capacity reserve charges as commodity costs. Interstate reasoned that these transition costs would be incurred in order to secure system supply gas and therefore should be billed as commodity.

III. Comments of the Department

The Department recommended that the Commission approve the Company's request for an increase in demand entitlements and its proposal to convert its entitlements to conform to Northern's restructured services. The Department disagreed with Interstate's proposal to recover the SMS, SBA, FDD, and Canadian capacity reserve charges as commodity.

The Department stated that SMS, SBA, and FDD charges are designated by Northern as demand charges and should be passed through by Interstate as demand charges. The Department also reasoned that these charges are incurred for the needs of firm (not interruptible) sales customers because interruptible customers can if necessary be curtailed.

The Department stated that the Canadian charges reflect the amount paid by Interstate for pipeline contracts to reserve capacity and should therefore be billed as demand costs.

The Department compared the rate impacts of the Company's rate design proposal with the Department's suggested version. Interstate's proposal would increase rates to the Company's single large volume interruptible customer by approximately 22% and to the Company's 44 small volume interruptible customers by about 21%. Firm customers would experience a rate decrease of approximately 9%. By contrast, the Department's proposal would increase rates by approximately 4% to the large volume interruptible class and to the small volume interruptible class. Under the Department's proposal, firm customers would experience a rate decrease of approximately 7%.

Although the Department did not recommend rejecting the Company's SMS proposal, the Department did question the use of this expensive service as a primary source of pipeline capacity for moving summer "swing" gas onto the Interstate system. The Department recommended that the Company explore less expensive alternatives and report on its use of SMS in the 1994 Annual Automatic Adjustment Report.

The Department recommended that the Company change from booking its capacity release revenue credits in FERC Account No. 804 to booking in FERC Account 805.1.

Finally, the Department found that the Company over-recovered its gas costs by at least 16.5% in its November and December, 1993, PGAs. The Department recommended that the Commission order an immediate refund of the overcharge.

IV. Commission Action

The Company's proposed level of entitlements, restructuring of its entitlements to reflect Northern's restructured services, and recovery of transition costs through the PGA are not controversial. The Commission agrees with the Company's proposal for these matters.

Interstate and the Department differ on the classification and billing of charges as demand or commodity. The Department has also raised issues regarding the appropriate FERC account for capacity release revenues, the Company's reliance on SMS, and the implementation of a refund.

A. Classification and Billing of Charges

As the post-636 energy industry moves to a more competitive and market-based structure, reasonable utilities may differ in their characterization of service charges and in their allocation of costs. In this case, Interstate has designated the SMS, SBA, FDD, and Canadian charges as commodity charges and allocated them to firm and interruptible sales customers. The Company has stated that all sales customers contribute to these post-636 costs and therefore all sales customers must share in their recovery.

The Commission finds that Interstate has articulated a reasonable viewpoint of these charges. Post-636 gas utility rate design will require analysis of cost components and market forces. At the same time, rate design decisions will continue to be reached in the context of public policy considerations, such as social value and ability to pay. In this case, the Department's concerns regarding rate shock for interruptible customers do not outweigh the basic equity of Interstate's position. The Commission will approve Interstate's proposal for designation and cost allocation of the Northern services and charges.

The Commission notes that another utility may reasonably designate these costs as demand. The facts will differ among utilities. There may be significant differences among utilities in such factors as the FERC settlements reached with the LDCs' pipelines and suppliers, the transition costs being passed to the LDCs, and the LDCs' ratios of interruptible to firm customers.

Particularly in this stage of transition and development in the post-636 era, the Commission will carefully examine each utility's cost recovery mechanism and decide upon its merit in light of the utility's unique set of facts.

B. The Appropriate FERC Account for Capacity Release Revenue Credits

The Commission agrees with the Department that the Company should book all of its capacity release revenues to FERC Account 805.1 (purchased gas cost adjustments) rather than to FERC Account 804 (natural gas city gate purchases), as proposed by the Company.

FERC Account 805.1 is appropriate because it is the PGA true-up account and is used for making adjustments to the Company's overall cost of gas. Placement of capacity release revenues in this account would also be consistent with past Commission treatment of this issue.

C. The Department's Recommendation for Further Filings on SMS

Interstate stated that SMS no-notice transportation service is the best means of managing its summer load swings, largely attributable to customers' use of grain dryers.

The Department stated that SMS is too costly and is not meant to manage summer swing load requirements; SMS is designed as a no-notice transportation service for moving swing gas supplies during the heating season. While the Department did not oppose the Company's proposed SMS use it recommended that the Company report on its use in future filings.

The Commission agrees with the Department that the Company's use of SMS should be further investigated. The Commission will require Interstate to review and evaluate the amount of SMS entitlement that it has and its use of SMS in the Company's 1994 Annual Automatic Adjustment Report.

D. Refund Resulting from PGA Errors

In its comments the Department recommended that Interstate refund amounts overcollected in its November and December PGAs.

On August 29, 1994, Interstate filed a request for a variance to Commission rules to allow the Company to make a one-time 1994 refund of all amounts owing to customers. Docket No. G-001/AA-94-784. That matter is still pending.

The Commission will therefore refer consideration of a refund of the PGA overcollections to Docket No. G-001/AA-94-784.

ORDER

1. The Commission approves Interstate's November 29, 1993, petition.

2. Interstate shall book all of its capacity release revenues to FERC Account 805.1 until the money is returned to ratepayers in the following year's Annual True-Up Adjustment.

3. In its 1994 Annual Automatic Adjustment Report, Interstate shall review and evaluate the amount of System Management Service entitlements it has and its use of those entitlements.

4. The Commission will consider a possible refund of overcollections in the November and December PGAs in Docket No. G-001/AA-94-784.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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